*** THE HONOURABLE SRI JUSTICE GODA RAGHURAM**

+ WRIT PETITION NO. 26276 of 2006

% FRIDAY, 2ND DAY OF MARCH, TWO THOUSAND SEVEN

M/s. Sri Srinivasa Rice and Floor Mill,
a partnership firm represented by its Managing Partner,
Sure Yoganandam, Guntur and others.
.

… Petitioners

versus

$ The Authorized Officer, State Bank of India,
Atchampet, Guntur district and another.

… Respondents

! Counsel for the petitioner : MR. Sriram representing
MR. D.V.Sitharam Murthy

^ Counsel for the respondents : MR. Deepak Bhattacharjee

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>Head Note:

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THE HON'BLE SRI JUSTICE GODA RAGHURAM

WRIT PETITION NO.26276 OF 2006

BETWEEN:

M/s. Sri Srinivasa Rice and Floor Mill,
a partnership firm represented by its Managing Partner,
Sure Yoganandam, Guntur and others.

…Petitioners

And

The Authorized Officer, State Bank of India,
Atchampet Guntur district and another.

...Respondents

THE HON'BLE SRI JUSTICE GODA RAGHURAM

WRIT PETITION NO.26276 OF 2006

ORAL ORDER

Heard Mr. Sriram, learned Advocate representing Sri D.V.Sitharam Murthy, the learned counsel for the petitioners and Sri Deepak Bhattacharjee, the learned counsel for the respondents. At the request of the learned counsel the writ petition is taken up for hearing and is disposed of by this judgment.

A notice dated 1.9.2006 was issued to the petitioners by the respondent-bank, being one u/Sec.13(2) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 ('the Act'), intimating the petitioners that the financial assets/credit facility (extended to them) had become irregular, the debt was classified as a non-performing asset (NPA); that the outstanding liability as on 28.8.2006 was Rs.68,62,272/- and that the petitioners should repay the same with further interest, incidental expenses and costs, failing which the bank would exercise its rights u/Sec.13(2) of the Act and other applicable provisions. By a notification dated 27.11.2006 u/Sec. 13(4) of the Act r/w Rule 8(1) and

(2) of the Security Interest (Enforcement) Rules 2002 ('the Rules'), notice for taking possession on 24.11.2006 of the specified property was issued and published in the newspapers.

The writ petition challenges the notice u/Sec.13(2) of the Act, the paper notification dated 27.11.2006 and also seeks a declaration that the action of the respondents in classifying the first petitioner's account as a NPA is illegal, arbitrary and contrary to the provisions of the Act. A consequent direction not to take coercive steps pursuant to the impugned notice and notification is also sought.

The first petitioner is a registered partnership firm, the 2nd petitioner is the first petitioner's Managing Partner and the 3rd petitioner, the son of the 2nd petitioner.

During 1997-98 the first petitioner availed a term loan for its business purposes. According to the respondent-bank this account and other accounts of the first petitioner with the bank became irregular. The bank thereupon decided to recall the advances and transfer the account to 'recalled debt account'. The bank also decided to approach the Debts Recovery Tribunal under the provisions of the Recovery of Debts Due to Banks and Financial Institutions Act 1993 ('the 1993 Act').

At the above stage of the matter the petitioner solicited a One Time Settlement (OTS). In view of this request the bank did not proceed under the provisions of the 1993 Act. On 5.3.2002 after the loan account was determined (in 2001) as NPA, in view of the petitioner's request an OTS was approved on 5.3.2002. Under this scheme the petitioner was required to pay Rs. 60.50 lakhs with further interest. The petitioners paid only Rs.30.06 lakhs in installments and after selling some of the mortgaged properties with the prior permission of the respondent-bank.

As the petitioners failed to conform to the terms of the OTS, the OTS was treated as inoperative and the bank decided to proceed against the person, the properties and the securities furnished by the petitioners, for recovery of the entire outstanding debt after giving

credit to the amounts already paid.

At this stage, the petitioners again sought rehabilitation. With a view to afford a further opportunity a rehabilitation scheme was sanctioned providing a fresh working capital term loan of Rs.30 lakhs, clearly incorporating a condition that the first petitioner was required to bring in another sum of Rs.30 lakhs as margin money. By a letter dt 16.3.2005 on specified conditions the rehabilitation package was sanctioned. One of the conditions of the package was that only Rs.15 lakhs would be immediately released subject to margin requirement fulfillment and release of the other Rs.15 lakhs would only be considered after the satisfactory performance of the unit is observed for a period of six months (Para-7(k) of the bank's letter dated 5.4.2005).

The performance of the 1st petitioner unit did not come up to the expectations of the respondent-bank and there was also a request for deferment of the term loan installments. The first petitioner also failed to bring in the stipulated equity or margin money of Rs.15 lakhs within the six months period agreed upon. Instead the petitioner requested release of the balance working capital limit of Rs.15 lakhs. At this stage the bank decided to recall the advances. By its letters dated 10.3.2006, 28.4.2006 and 1.8.2006, the bank intimated the first petitioner that it is recalling the advances and that the entire outstandings due with up-to-date interest should be repaid forthwith, failing which the bank would proceed to enforce its claim for recovery of dues and for sale of assets and the properties charged/mortgaged to the bank.

On receiving the recall notices the first petitioner submitted a representation seeking reconsideration of the decision. The request for reconsideration was rejected. Thereafter the respondent-bank set in motion the process under the provisions of the Act for recovery of the outstanding amounts and issued a notice u/Sec.13(2) of the Act followed by a notice u/Rule 8 of the Rules relatable to the exercise of power u/Sec.13(4) of the Act. The petitioners are thus before this court.

The principal contention advanced on behalf of the petitioners by Sri Sriram learned counsel is that the conduct of the respondent-bank in classifying the loan account as NPA is arbitrary and contrary to the provisions of the Act.

The applicable statutory architecture :-

Sec.2(o) of the Act defines a 'Non-Performing Asset' as an asset or account of a borrower which has been classified as substandard, doubtful or loss asset in accordance with the terms or under the guidelines relating to assets classification issued by the Reserve Bank. Sec.13(2) mandates the issuance of a notice by a bank to a borrower where the borrower's account in respect of a specified debt is classified by the secured creditor as NPA, intimating the extent of liability and calling upon the borrower to discharge the specified liability in full within 60 days from the date of notice, duly intimating that on failure the secured creditor would be entitled to exercise all or any of the rights u/Sec. 13(4). Sec. 13(3) specifies the requirements of such notice. Sec.13(4) empowers the secured creditor to take recourse to one or more of the specified measures to recover the secured debt, which includes the right to take possession of the secured assets of the borrower and the right to transfer by way of lease, assignment or sale.

Classification of the account as NPA is thus a condition precedent to the entitlement of a secured creditor to avail the special remedial measures under the Act. There is however nothing in the provisions of the Act which mandates a particular and formal process for classifying an account as NPA. What all the statute obligates is that the classification should be in harmony with the directions or guidelines issued by the Reserve Bank, relating to the classification of assets.

The definition [Sec.2(o)] also incorporates the generic characteristics of NPA. Accordingly an asset/account which is substandard, doubtful or a loss asset may be classified as NPA subject to the directions/guidelines on this aspect by the Reserve Bank of India.

The only pleading in the writ petition relatable to the petitioners' impeachment of the classification as NPA, is set out in Para-8 of the writ petition and reads: "*The 1st Petitioner was categorized as NPA in contravention of the provisions of the Act and the guidelines issued by the Reserve Bank of India. There was no application of mind in the matter of categorizing the 1st Petitioner as an NPA.*" This pleading is totally bereft of particularity and is a vague and unspecific pleading.

The respondent-bank is an instrumentality of the State and there is a prima facie presumption that its conduct in classifying the account as NPA is regular and bona fide. It is therefore the petitioners' initial obligation to displace such prima facie presumption by cogent, clear and relevant pleadings setting out the material facts to substantiate the allegation. It is only upon such a pleading and production of evidentiary material in support of such pleading that the burden would shift to the respondent-bank to answer a charge of non-application of mind or abuse of the discretion with regard to classification of the account as NPA. The petitioners have woefully failed to either plead or establish and therefore to discharge the burden upon them, to warrant a response by the respondent-bank.

The theme of the petitioners is that the 1st petitioner-Unit was functioning well but had encountered certain adverse market conditions and the respondent-bank oblivious to its social obligations had recalled the debt apart from failing to adequately service the debt further by a fresh and timely infusion of credit. In para-4 of the writ petition it is pleaded that the 1st petitioner was declared as NPA by the bank in 2001. In para-4 of the counter affidavit, it is the case of the bank that since September 2000 the loan facility availed became NPA in the books of the Achampet branch and the bank therefore decided to recall the advances, some steps were also initiated towards filing of an application before the Debts Recovery Tribunal (under the provisions of the 1993 Act). This course was however not pursued due to the petitioners' request for an OTS. The petitioners assert (para-9) that the first petitioner is a running unit and there has

been no default in the payment of installments and the earlier defaults cannot be taken into consideration in view of the OTS and the rehabilitation package having succeeded the earlier classification as NPA. There were thus no jurisdictional facts justifying the exercise of power u/Sec.13 of the Act, is the substantive alternate contention.

Responding to the above allegation, the bank pleaded denial and the following relevant facts.

" *05. It is respectfully submitted that at the time of conveying the terms and conditions of sanction of rehabilitation package, the petitioner had not expressed any reservations nor made any objection for the terms and conditions which are accepted in toto for the discretion with the petitioner either to accept or not to accept the terms and conditions of the rehabilitation. Sri Yoganandam, the petitioner No.2,in his application for sanction of rehabilitation have requested for a term loan of Rs.28.50 lakhs by rescheduling the existing debt and for a fresh working capital limit of Rs.30.00 lakhs. The respondent bank considering the need for infusing of additional capital by the unit agreed to release the sum of Rs.30.00 lakhs in two instalments. It was decided that the second instalment of Rs. 15.00 lakhs will be released after observing the performance of the petitioner. After the release of sum of Rs.15.00 lakhs, the respondent bank came to know that the petitioner No.2 entered into an agreement of sale with one Smt. Maria Nakshtramma w/o Pitchi Reddy and one Smt. Gopy Jaswanta Mary w/o Lurdu Reddy agreeing to sell the Shop No.4 in SRSM Complex for a sale consideration of Rs.2,40,000/- by way of settlement of pronote dues payable to them. The purchasers also confirmed that the physical possession of the shops were given to them and they have let out the shop on a monthly rent of Rs.500/-. Similarly the Bank also could get documentary evidence in respect of three other shops namely shop No.5, 6 and 12. The respondent-bank do have reasonable apprehension that the petitioners might have entered into similar agreement in respect of the balance shops also. The above action of the petitioners amounted to committing the act of breach of trust and it was a nack which amounted to jeopardizing the interest of the respondent-Bank as a mortgagee. It is worth mentioning that all the shops were mortgaged with the respondent-Bank and the petitioners deliberately and willfully without seeking prior leave of the petitioner-Bank entered into such transaction.*

06. It is respectfully submitted that the credit summation was only Rs.48.61 lakhs during the period between 21-04-2005 to 08-02-2006 and the petitioners claim of sales turnover of Rs.72.00 lakhs. The balance amount of Rs.23.39 lakhs is not accounted for and it is clear that the said amount is not routed through the loan account. The rice sales in the counter generally by way of demand draft/cheques and there is a very little cash transactions and it is evident that the balance sum of Rs.23.79 lakhs out of the admitted sale turnover of Rs.72.lakhs was routed to some other accounts.

07. It is humbly submitted that in the rice mill business the maximum credit period limit offered by the miller is 21 days to 30 days. Most of the receivable shown by the petitioners was more than 90 to 120 days old. The respondents therefore independently verified the transactions covered by the receivables of Rs.18,91,468/- shown in the stocks statement as on 28-01-2006 and it came to light that the suppliers obtained receipts on payment of entire amount as shown above from the petitioner. In fact there were no dues as on 20-07-2006 and the receivables were diverted from some other purposes and the entire amount of Rs.18,91,468/- was falsely shown as outstanding in the stock statement as on 28-01-2006. The petitioners adjusted the receivables by issuing simple receipts. The adjustments were perfected by issuing receipts for amounts of less than Rs.20,000/- each. The verification revealed that for an amount of Rs.2,80,000/- the petitioners issued 14 receipts of Rs.19,000/- each of 14 consecutive days during the period from 1st to 15th April,2006. Further the verification revealed that the petitioners did not project the true performance of the unit. The following unsatisfactory views were deliberately and willfully suppressed:

(a) Drawings were made in the CC account against inflated/marked rates of stock statement without actual holding of sufficient stocks valued at rates specified by FCI;

(b) The quantity of stocks reflected in stock statements were not tallying with the actual stocks held. As an example, it was that in the stock statement dated 14-05.2001, non-levy stocks of paddy were shown as 4413.99 quintals as against the actual holding of 142 quintals;

(c) The unit was maintaining a Current Account with the Tamilnad mercantile Bank Ltd., Patnam Bazar Branch, Guntur to which account the DD No.605344, dated 7.1.2002 received from SIB Branch, Dhanbad (representing

advance payment in respect of colour sorter machine sold to some party in Bihar) was credited. It has also been stated that the unit was trying to dispose of the machine without Bank's prior permission at that time;

(d) *It was reported that the local businessmen were in the habit of collecting produce/funds from farmers of Atchampet and neighboring villages at higher rates of interest and using the same for their own business operations. It has been stated that three of the business persons/middle brokers have collected funds nearly to the tune of Rs.2.00 crores in aggregate from local farmers. Instances were reported that when these funds were not repaid/adjusted with the farmers, due to the pressure mounted by the farmers, one of the three business persons committed suicide and that two were contemplating filing of Insolvency Petition. This has been stated as one of the reasons for the poor chances of reliability of collateral securities.*

(e) *… … …*

(f) *The respondent bank wrote a letter to the unit on 18th November,2002 advising that even after a lapse of 4 months they had not paid the agreed compromise amount and that if the balance amount is not paid by 25th November,2002, the compromise proposal approved by the bank earlier would be treated as cancelled. In response to this letter the petitioner unit wrote a letter dated 22.11.2002 advising that they were arranging to obtain a loan from a private finance company which will be released by 30th November,2002. They alsio enclosed a letter given by one "Indira World Wide Finance & Respondent-finance Corporation, No.23/2, Tiffany's Building, Vittal Malya Road, Bangalore-560 001. The letter dated 20.11.2002 addressed to the Branch Manager of respondent bank simply stated that the loan ofRs.1.50 crores sanctioned to the party would be disbursed on or before 30th November, 2002. The letter was signed by one R.Rajesh on behalf of the finance company. The very appearance of the letter gives rise to a strong suspicion that the finance company under reference could be a fake one as in the normal circumstances no private finance company in Bangalore would be willing to sanction a loan of Rs.1.50 lakhs to a small firm in a remote village in Guntur District of Andhra Pradesh without making proper enquiries. Especially, when they know that the party is already having dues to State Bank of India, no company would normally sanction such a substantial loan of Rs.1.50 crores just like that:*

(g) *The petitioner recently tried to locate the company by making telephonic enquiries to the numbers mentioned in their letterhead and came to know that there is no such*

company currently existing there with the telephone/fax numbers printed on the letter head;

(h) The borrower did not adhere to the payment schedule contemplated under the compromise proposal. On account of undue delay on the part of the borrower in making the payment, a notice of cancellation of the compromise settlement was served on 19.11.2002. A notice under SARFAESI Act,2002 was also served on 17.12.2002. At this stage at the specific request of the borrower a time up to 3 months was allowed and legal action was deferred during the time granted. The borrower disposed off all the prime properties but has paid only Rs.32.00 lacs.

(i) A perusal of the balance sheets of petitioner company for the years ended 31st March,2000 to 2004 reveals the following position of the Partner's capital accounts:

31.03.2000	*-*	*Cr.balance of Rs.10.95 lacs*
31.03.2001	*-*	*Cr.balance of Rs.9.18 lacs*
31.03.2002	*-*	*DC .balance of Rs.13.32 lacks*
31.03.2003	*-*	*DC. Balance of Rs.f13.19 lacs*
31.03.2004	*-*	*DC balance of Rs.21.28 lacs*

As can be seen from the above, the partners capital accounts have worsened from a credit balance of Rs.10.95 lacs as on 31.03.2000 to an overdrawing of Rs.21.28 lacs as on 31.03.2004 resulting in a capital erosion of Rs.32.23 lacs during the 4 year period. It has also been stated that depreciation has not been charged during the year 2003, which, if charged, will result in further increase in the partners over drawings. However, the rehabilitation proposal did not contain any mention of the position of their capital that existed then or how the promoters would bring in the stipulated matching funds.

(j) Diversion of funds from cash credit account to repay outside dues has been reported. The reduced sundry creditors for trade as per their financial statements are reported as under and they provide a corroborative evidence:

March, 1998	*-*	*Rs.41.46 lacs*
March,1999	*-*	*Rs.90.10 lacs*
March,2000	*-*	*Rs.44.53 lacs*
March,2001	*-*	*Rs.12.23 lacs*
March 2002	*-*	*Rs.10.23 lacs*
March,2003	*-*	*Rs. 6.35 lacs*

(h) Maintaining accounts with other banks without the express permission of respondent bank;

(i) It has been stated that certain stocks of paddy/rice/brokers belonging to petitioner company have been seized by police in the year 2000 for violation of control orders under E.C.Act,1955 and were letter auctioned at Sattenapalle. As per the letter dated 6.6.2006 of Joint Collector & Additional District Magistrate, Guntur addressed to Mandal Revenue Officer, Sattenapalle.

(j) It has been observed that the collateral securities/assets were

valued at Rs.25.75 lacs at the time of considering the compromise proposal in 2002 and the same assets were valued again at a much higher level of Rs.41.24 lacs in 2005 at the time of considering the rehabilitation proposal.

It is humbly submitted that the valuation submitted in 2002 at the time of compromise proposal was as follows:

Description of the property	*Valuation Rs. Lacs*	*Remarks*
Ac.0.87 cents of vacant site at D.317,Chamarru revenue Village vide Sale deed No.164/1998	*0.44*	
289 Sq.yards RCC Slab Roof godown at D.3-27 vide sale deed No.2335/96 dt 27.2.2002		*Based on the valuation report furnished by C.Sundara Rao SE(Retd) Arundalpet Guntur.*
297 sq.yards GI sheet roof godown at D.3-28A vide sale deed No.70/94	*21.31*	
950 sq.yards site with rice mill, office room, two sheds at D.3-28 vide sale deed 299/91		
Movable machinery of Rice Mill (salvage value)	*4.00*	
Total	*25.75*	

The valuation submitted in 2005 at the time of rehabilitation proposal as follows:

Description of the property	*Valuation Rs. Lacs*	*Remarks*
Ac.0.87 cents of vacant site at D.No.317,Chamarru revenue village Vide Sale Deed No.164/1998	*9.80*	
289 sq.yards RCC Slab Roof godown at D.3-27 vide sale deed No.2335/96	*4.00*	*Based on the Valuation report dated25.2.2002 furnished by*

A.A Associates *297 sq. yards GI sheet roof godown at Arundalpet* *D.3-28A vide sale deed No.70/94,*	*2.76*	*Guntur*
950 sq.yards site with rice mill, office room, two sheds at D.3-28 vide sale deed 299/91	*5.38*	
movable machinery of Rice Mill (salvage value)	*19.30*	
TOTAL	*41.24*	

With regard to increased exposure at Rs.67.77 lacs and partial release of securities already permitted under the compromise proposal earlier, the security coverage with the existing collateral securities had deteriorated substantially."

While directing notice before admission, this Court on 20-12-2006 ordered maintenance of status quo as obtaining on that date. The order was extended from time to time.

As seen from the pleadings on behalf of the respondent bank there was ample material for the bank to assess and classify the loan account of the 1st petitioner. The petitioners have not pleaded and with material and factual particulars that the classification by the respondent bank of the loan account of the 1st petitioner is in transgression of any directions or guidelines issued by the RBI in respect of asset classification. From the facts pleaded in the bank's counter (of which there is no rebuttal by the petitioners) it is apparent that there was ample factual and material for the bank to arrive at an assessment and to make a classification regarding the loan account.

There is, as considered earlier in the judgment no statutory format, express or by necessary implication, that requires the respondent bank to follow a particular or formal procedure or requires a formal declaration as a condition precedent to classification of debt as NPA. From the scheme of the Act in general and the provisions of Sec.13(2) in particular the conclusion is compelling that the legislature has

consecrated the power, authority and discretion (to classify a debt as a NPA) to the secured creditor within the generic guidelines to be ascertained from the definition of a non performing asset [Sec.2(o)].

On the basis of the fact pleaded by the Bank in its counter-affidavit the bank must be held to have legitimately inferred and assessed the account of the 1st petitioner as falling within the legislatively delineated spectrum – sub-standard, doubtful or loss asset.

A wide margin of discretion is available to the respondent bank as the secured creditor, within the legislative presents of the Act, to assess and classify a debt but within the legislative framework. This Court is not constituted an appellate authority over the bank's exercise of discretion in this area. The respondent bank, as legislatively recognized is an institution having the requisite expertise to form a commercial judgment on known principles of banking practices and procedures fertilized by R.B.I directions and guidelines to assess and classify a debt as NPA. From the wealth of material pleaded in the counter-affidavit the bank had assessed the debt as non-performing asset. On facts , the petitioners have miserably failed to establish that such assessment by the bank is perverse or irrational to a degree warranting oversight and correction in judicial review.

The alternate case of the petitioners proceeds on a premise that the bank having earlier treated the debt as NPA (in 2001) was required, but failed to again classify the debt as NPA before proceeding under the provisions of the Act. The petitioner's assumption is that there was a need to formally declare the debt as NPA; that it had done so in 2001; that it was necessary to again formally declare the debt as a NPA: that no such formal declaration of classification was made before now proceeding under the provisions of the Act. There appears no statutory or normative foundation for any of these assumptions on the basis of which the alternate challenge is projected. What all Sec.13(2) read with 2(o) of the Act requires is a classification by a Bank of a debt as NPA within the legislative guidelines spelt out in the definition of NPA. Such a classification may in a given case be expressed in a formal internal declaration.

That course of action however does not appear, from the text of the Act, to be a condition precedent. What all required is an assessment and classification. It is not also required that the magic word " NPA" should be recorded in every circumstance. If on a holistic consideration of the relevant facts, the bank is satisfied that an account/asset/debt of a borrower is standard/doubtful/ loss asset in accordance with directions or guidelines on this aspect by the R.B.I, a compelling inference that the assessment and classification by the bank that it is NPA has been properly arrived at, must follow.

The notice issued under Sec.13(2) of the Act (01-09-2006) specifically asserts that the operation and conduct of the financial assets/credit facility had become irregular and that the debt was classified as NPA in accordance with the directives or guidelines relating to asset classification issued by the R.B.I. The notice also states that such classification was consequent on the default committed in repayment of the principal debt and the interest thereon. There is also a catalogue of correspondence and a succession of events preceding the Sec.13(2) notice, which legitimize the classification within the plenitude of discretion available to the respondent bank. The petitioners have not established to the contrary.

In the aforesaid circumstances the claim of the petitioners that the debt was categorized as NPA in contravention of the provisions of the Act and the guidelines issued by R.B.I; that there was no application of mind in the matter of classification; or that there was no default in payment of installments and the earlier defaults could be taken into consideration, are pleas which have no factual basis and are buttressed by no legal principle. Consequently, the claims are wholly misconceived and is accordingly rejected.

The respondent bank has proceeded against the petitioner in procedurally faithful adherence to the percepts of the provisions of Sec.13 of the Act. Its notice under Sec.13(2) of the Act dated.01-09-2006 sets out all relevant particulars. The petitioners' representation thereto including the one dated.13-11-2006 was responded by the bank's reply dated.22-11-2006 (under Sec.13(3)(A)

of the Act). Possession notices under Sec.13(4) have been issued in accordance with the mandate of Rule.8 of the Rules The petitioners also do no urge an issue with regard to the fulfillment of the procedural obligations by the bank. The petitioners' singular contention is that there are no jurisdictional facts legitimizing the classification as NPA. This Court has already and hereinabove rejected such contention as misconceived.

In the totality of circumstances there are no merits in the writ petition. The writ petition is accordingly dismissed. The order of status quo granted on 20-12-2006 and extended from time to time thereafter, is hereby declared as dissolved. There shall be no order as to costs.

Dt: 02.03.2007 ----------

LR Copy to be marked Justice G. Raghuram

(B/O)

Pvsn/Tsnr